Supreme Court, U.S.
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No. 06-49

In The Supreme Court of the United States

JOHN HANCOCK LIFE INSURANCE COMPANY; SIGNATOR INVESTORS, INC.; SIGNATOR INSURANCE AGENCY, INC.,

Petitioners,

vs.

RALPH F. PATTEN, JR.,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

PETITIONERS' REPLY BRIEF

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ARGUMENT

I. The Issues Are Preserved for Review

Respondent's claim that Petitioners did not "properly raise" below the arguments they raise here (Opp. 5) is wrong. *First*, as the Fourth Circuit agreed, Petitioners below invoked "the circumscribed scope of review which [the federal courts] are obliged to apply in assessing an arbitration award." Pet. App. 10a. That issue – *i.e.*, how circumscribed a court's review of the merits of an arbitral award must be – is exactly the issue raised here. "'[O]nce a federal claim is properly presented, a party can make any argument in support of that claim; parties are not limited to the precise arguments they made below.'" *Lebron v. Nat'l R.R. Passenger Corp.*, 513 U.S. 374, 379 (1995) (citation omitted).

Second, Respondent argues Petitioners did not challenge prior Fourth Circuit precedent below and relied in part on *Remmey v. PaineWebber, Inc.*, 32 F.3d 143 (4th Cir. 1994). This ignores that *Remmey* was fully consistent with the strict articulation of manifest disregard in the Second and Ninth Circuits: that the "'arbitrators understand and correctly state the law, but proceed to disregard the same.'"[1] *Id.* at 149. Although the court below quoted the *Remmey* standard, it proceeded to reformulate the standard in a way that is radically at odds with *Remmey*'s words. *See infra* at 2-4.

Third, contrary to Respondent's argument, Petitioners did not waive the argument that the "essence of the agreement" standard does not apply under the FAA. Petitioners urged below that "'[a] legal interpretation of an arbitrator may *only* be overturned where it is in manifest

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[1] This quotation ultimately comes from *San Martine Compania de Navegacion, S.A. v. Saguenay Terminals Ltd.*, 293 F.2d 796, 801 (9th Cir. 1961). Petitioners also quoted *Jih v. Long & Foster Real Estate, Inc.*, 800 F. Supp. 312, 320 (D. Md. 1992), quoting *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, 808 F.2d 930, 933-34 (2d Cir. 1986).

disregard of the law.'" Answering Brief 6 (emphasis added). The Fourth Circuit rejected this claim, expressly noting its decision conflicted with *Westerbeke Corp. v. Daihatsu Motor Co.*, 304 F.3d 200, 220-21 (2d Cir. 2002). The issue was not only "pressed" but "passed upon" below. *See, e.g., Lebron*, 513 U.S. at 379.

Fourth, this Court may consider questions antecedent to the precise issues considered below. *See United States Nat'l Bank of Or. v. Indep. Ins. Agents of Am., Inc.*, 508 U.S. 439, 447-48 (1993). As Respondent acknowledges, it would have been futile to ask the panel to disregard Fourth Circuit law allowing some measure of merits review of arbitral awards.

Finally, Respondent was not required to petition the Fourth Circuit *en banc* to repudiate the "manifest disregard" or "essence of the agreement" doctrine. *See* Opp. 6-7. A petition for *en banc* review is not a prerequisite to seeking certiorari. *See* S. Ct. R. 13(3). Moreover, if Petitioners had succeeded in persuading the court, *en banc*, to repudiate the manifest disregard doctrine, that would only have exacerbated, not resolved, the conflict among the circuits.

II. This Case Presents Genuine Intercircuit Conflicts

A. In Conflict with Every Other Circuit, the Court Below Did Not Require a Showing of Actual Arbitral Misconduct.

Respondent's main answer to the conflicts between the decision below and the law in at least ten other circuits is to insist this case involved a "*knowing refusal* [by the arbitrator] to follow the law as he understood it." Opp. 9 (emphasis added).[2] Respondent thus concedes that, at

[2] *See also* Opp. 10 ("knowing refusal to give effect to unambiguous contractual language"), 11 ("arbitrator knew [award] was 'contrary to the plain language of the contract'"), 12 ("deliberate disregard of

(Continued on following page)

least in every circuit *except* the Fourth, an arbitrator must be "fully aware of the existence of a clearly defined governing legal principle, but refused to apply it, in effect, ignoring it," before vacatur is appropriate. *Id.* at 13. Respondent argues that, since the court below paid lip service to this test, no intercircuit conflict exists. *Id.* at 9.

Respondent's argument ignores the Fourth Circuit's stated grounds for vacatur. Nowhere did the majority find Arbitrator Truesdale *knew* his decision was contrary to applicable law. There would have been no basis for such a finding, as the full arbitral record was not submitted in the record below.

The Fourth Circuit recognized that the Management Agreement was ultimately silent on the matter of a filing period, and that there is substantial authority that an arbitrator may supply implied terms when a contract is silent. Pet. App. 11a. Arbitrator Truesdale doubtless believed in good faith (and in Petitioner's view, correctly) that contractual silence did not mean that the filing time was unlimited, and that he could "look . . . for guidance" to the parties' prior agreement, *id.* at 30a – even if that agreement was no longer in force – in determining what limit was reasonable. *See also id.* at 87a (Respondent's concession that the two agreements were "independent, yet complimentary").

The Fourth Circuit, however, found that this approach "contradicted the plain and unambiguous terms of the Management Agreement," which stated it "'supersede[d]'" prior agreements, and the court suggested that the only "reasonable" way to fill the gap would be through a complex choice-of-law analysis. *Id.* at 11a-12a. On that basis, the court held the arbitrator "*appears* to have revised the governing arbitration agreement on the basis of his own 'personal notions of right and wrong.'" *Id.* at 12a (emphasis added).

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unambiguous contractual language" "knowing and deliberate disregard of the law"), 13 ("conscious refusal"), 15 (same).

As Judge Luttig pointed out, the majority in no way required that the arbitrator in fact consciously ignored the law. *Id.* at 14a-15a. In effect, the majority reinterpreted "manifest disregard of the law" to mean apparent disregard of the law, and found that the law "appears" to have been disregarded when the arbitrator's interpretation of "unambiguous" contractual terms is "not reasonable" in the court's view. *Id.* at 12a, 11a. The court's approach thus reduced "conscious disregard" to a fiction by equating it with "clear error." *See id.* at 14a (Luttig, J., dissenting).

In sum, the Fourth Circuit's error was not a mere misapplication of a correctly-stated standard. Rather, the court articulated and applied a wholly incorrect standard, which effectively reinterpreted and reformulated the stricter standard it quoted from prior cases. This presents a clear conflict with other circuits, warranting this Court's review.

B. The Standard Applied Below Undisputedly Conflicts with the Seventh Circuit's "Excess of Authority" Standard.

In any event, Respondent agrees that the Seventh Circuit applies a stricter "manifest disregard" standard than the Fourth or any other circuit applies. Opp. 20. In the Seventh Circuit, an award can be vacated for "manifest disregard" only if the tribunal exceeded its authority by (1) directing the parties to perform an illegal act, or (2) openly refusing to apply a rule of decision explicitly required by the parties' contract. *See Wise v. Wachovia Sec., LLC*, 450 F.3d 265 (7th Cir. 2006); *George Watts & Son, Inc. v. Tiffany & Co.*, 248 F.3d 577 (7th Cir. 2001). In contrast, the Fourth Circuit's version of "manifest disregard" does not depend, even vaguely, on a showing that arbitrators exceeded their powers.

Respondent's lengthy argument that this case does not implicate this patent conflict between the Fourth and the Seventh Circuits (Opp. 17-20) is wholly without merit.

For example, Respondent's argument that *Watts* would allow vacatur, because the contract here supposedly required the arbitrator to apply Massachusetts law, not only has nothing to do with the reasoning of the court below but is plainly incorrect. The contract provides only that "[t]his Agreement" should be construed under Massachusetts law, Pet. App. 82a; it is silent on the law governing statutory claims related to the contract. *See* Pet. 8 n.2. Moreover, the time for bringing a claim is a procedural matter separate from the law governing the underlying claim. *See Sun Oil Co. v. Wortman*, 486 U.S. 717, 722-30 (1988); *see also Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 59-60 (1995). And in any event, there is no indication that the arbitrator here believed that looking to a prior contract for guidance in selecting an appropriate time limit, *see* Pet. App. 30a, breached Massachusetts law. *See, e.g.*, *Rational Software Corp. v. Sterling Corp.*, 393 F.3d 276, 279 (1st Cir. 2005) (looking to parties' prior course of dealing).

There also is no merit in Respondent's convoluted assertion that the Court should await some future Seventh Circuit *en banc* proceeding, in which the obscure differences Respondent perceives between *Watts* and *Wise* will one day be worked out. *Wise* cites *Watts* approvingly and reiterates the Seventh Circuit's strongly worded rule that manifest disregard may be found only "where the arbitrators exceeded their powers" and "direct the parties to violate the law." *Wise*, 450 F.3d at 268-69. The test in *Wise* – "whether the arbitrators had failed to interpret the contract at all," *see id.* at 269 – cannot be squared with the Fourth Circuit's judgment here, which turned on whether the arbitrator merely "appears" to have revised the agreement. Pet. App. 12a, 11a.

C. The Standard Applied Below Undisputedly Conflicts with the Fifth Circuit's "Significant Injustice" Standard.

Respondent also concedes that the Fifth Circuit, unlike the Fourth, would require him to show that enforcement

would "result in significant injustice" before an award could be vacated for manifest disregard. Opp. 15-16. He seeks to minimize this conflict as "purely theoretical," asserting that the Fifth Circuit has never vacated an award for manifest disregard. *Id.* But in the Fifth Circuit, Petitioners would have had a chance to prove the arbitrator's alleged error worked no injustice. That opportunity could well be dispositive, as Arbitrator Truesdale's approach granted Respondent a period for his statutory claims longer than or equal to that available in state or federal court. Pet. 8-9 n.2.

D. The Standard Applied Below Undisputedly Conflicts with Second Circuit Law Limiting the "Essence of the Agreement" Doctrine to Collective Bargaining Agreements.

The court below expressly stated that its application of the "essence of the agreement" test to a non-labor arbitration award conflicts with *Westerbeke*, 304 F.3d at 221-22. Respondent argues, however, that the "manifest disregard of the law" standard the Second Circuit applies in FAA cases is "functionally identical" to the "essence" doctrine. Opp. 21.

The Second and Fourth Circuits, however, treat "essence of the agreement" and "manifest disregard" as two distinct grounds for vacatur. Pet. App. 10a n.8; *Westerbeke*, 304 F.3d at 221-22. Moreover, the Second Circuit's "manifest disregard" test bears little resemblance to the "essence of the agreement" test applied below. In the Second Circuit, absent "explicit acknowledgment of wrongful [arbitral] conduct," an award may not be vacated for "manifest disregard" if it has even a "barely colorable" justification. *Id.* at 222. The Fourth Circuit's inference that the award did not "draw its essence" from the contract based on its substantive disagreement with the arbitrator's conclusion, Pet. App. 13a, employs the opposite presumption. That clear conflict merits the writ.

III. The Decision Below Substantially Conflicts with the FAA's Plain Language and This Court's Commitment to the Efficiency of Arbitration

Respondent argues that reversal here would "overturn a half-century of settled law." Opp. 23. The law on "manifest disregard" and "essence of the agreement," however, is anything but settled, and the rift in the lower courts on how to read this Court's brief and unexplained statements on the subject only grows wider. As the Seventh Circuit has stated, "the law in [this and] other circuits is . . . confused, doubtless because the Supreme Court has been opaque. The dictum in *Wilko* and *First Options* was unexplained and unilluminated by any concrete application." *Watts*, 248 F.3d at 580 (citing *Wilko v. Swan*, 346 U.S. 427 (1953), and *First Options of Chi., Inc. v. Kaplan*, 514 U.S. 938 (1995)).

Over fifty years after *Wilko* and nearly fifty years after the *Steelworkers* trilogy,[3] it is time for this Court to end the confusion. While the parties disagree about the propriety of merits review of arbitral awards, they agree this issue is crucial to the appropriate use of scarce judicial resources and to the use of arbitration as a mechanism for resolving disputes outside of litigation. *See* Pet. 25-26; Opp. 27.

Use of "manifest disregard" to delay or avoid enforcement has exploded in the last decade,[4] encouraged by

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[3] *United Steelworkers of Am. v. Am. Mfg. Co.*, 363 U.S. 564 (1960); *United Steelworkers of Am. v. Warrior & Gulf Nav. Co.*, 363 U.S. 574 (1960); and *United Steelworkers of Am. v. Enterprise Wheel & Car Corp.*, 363 U.S. 593 (1960).

[4] Westlaw searches show that, since 2000 alone, there have been at least 400 decisions in the District Courts addressing "manifest disregard," as a ground for vacating arbitration awards. Of the 197 cases ruling on the issue in the courts of appeals, *see* Pet. 27 & n.10, more than 70 percent were decided in the last decade. At least four more published appellate decisions (all in conflict with that below) have issued since the petition was filed. *See McCarthy v. Citigroup Global Markets Inc.*, No. 06-1001, 2006 WL 2673424 (1st Cir. Sept. 19, 2006) (to be published in F.3d); *D.H. Blair & Co., Inc. v. Gottdiener*, No.

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confusion in the law exemplified by the decision below. This trend increasingly threatens to turn arbitration from an alternative to litigation into a prelude to litigation. *See B.L. Harbert Int'l, LLC v. Hercules Steel Co.*, 441 F.3d 905, 913 (11th Cir. 2006). Even a cursory look at the lower court decisions on manifest disregard shows that merits review results in a full reexamination of the issues, no matter how deferential the standard applied. As Respondent concedes (Opp. 25) such review in all but the rarest cases leads to enforcement of awards, imposing great costs on the judiciary and parties while yielding concrete benefits to exceedingly few litigants.

The idea that this wasteful practice can be curbed by awarding fees and costs for abusive filings is mistaken. The lack of clarity in the law, exacerbated by decisions such as that below, makes it nearly impossible to distinguish frivolous from arguably meritorious filings, at least in some circuits. Allowing two layers of merits review on top of the arbitral process undermines parties' expectation that arbitral awards will be final and binding and frustrates this Court's mandate that arbitration agreements must be enforced so as to minimize litigation cost and delay. Pet. 26a.

Respondent asserts that this Court has "repeated[ly]" recognized the manifest disregard doctrine, citing *First Options*, 514 U.S. at 942. Opp. 23. But the Court's reference to "manifest disregard" in *First Options*, no less than in *Wilko* itself, was a passing dictum that did not directly confront the relevant provisions of the FAA or the policy underlying them. Both *Wilko* and *First Options* would have turned out the same way even assuming there is no merits review of arbitrators' awards: In *Wilko*, the issue was whether arbitrators could be trusted to decide Securities Act claims; in *First Options*, it was whether the parties had agreed to arbitrate disputes over the arbitrators'

04-3260, 2006 WL 2551218 (2d Cir. Sept. 5, 2006) (same); *Hollern v. Wachovia Sec., Inc.*, 458 F.3d 1169, 1176-77 (10th Cir. 2006); *Kurke v. Oscar Gruss & Son, Inc.*, 454 F.3d 350, 354-55 (D.C. Cir. 2006).

jurisdiction. The lower courts' perception that they are bound by these dicta has stymied their ability to develop the law coherently without further guidance from this Court. *See* Pet. 29 (citing cases); *Major League Baseball Ass'n v. Garvey*, 532 U.S. 504, 512 (2001) (Stevens, J., dissenting) (citing lack of guidance on "essence" test in labor cases).

Contrary to what Respondent suggests, Petitioners do not dispute that an arbitrator's deliberate refusal to apply mandatory law can sometimes give rise to statutory grounds for vacating an award. *See* Pet. 10-11. In *Wilko*, for example, the Court was faced with a statutory provision that, in express terms, precludes parties from contractually waiving compliance with the Securities Act. 346 U.S. at 430. It follows that, if parties agree in advance to arbitrate securities claims, their arbitration agreement may not direct or empower the arbitrator to intentionally disregard the requirements of the Securities Act. *See id.* But, to enforce this requirement, a court need only "ascertain that the tribunal took cognizance of the [statutory] claims and actually decided them," and may not examine the merits of the award. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 638 (1985); *see also Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 32 n.4 (1991).

In the case below, and in other cases like it, the provision that the arbitrator was found to have "manifest[ly] disregard[ed]" was merely a contractual provision, modifiable at any time by mutual consent and entrusted by the parties to interpretation by their chosen arbitrator. Though Respondent's claims included statutory nondiscrimination claims, the *statutory* limit for those claims was in no event longer than the one-year implied *contractual* limit applied by Arbitrator Truesdale. *See* Pet. 8-9 n.2. Respondent did not argue, and the Fourth Circuit did not find, that the arbitrator's decision was contrary to a statute, but only that it was contrary to a contractual provision. Any "safety valve" that may be required to protect statutory non-waiver requirements (Opp. 26) is

unnecessary and inapplicable in a contract interpretation case such as this.

Petitioners seek review of the basic question of when and under what circumstances there may be review of the merits of an arbitral award, despite the clear congressional command that no such review is to be had under the FAA. *See* 9 U.S.C. §§ 10, 11; Pet. 22-25. Respondent offers no good reason to deny review on these basic questions, which repeatedly arise in litigation and to which only this Court can bring clarity.

CONCLUSION

For all of the foregoing reasons and those stated in the petition for certiorari, the Court should grant the petition and reverse the judgment of the Court of Appeals.

Dated: New York, New York
September 26, 2006

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